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No. 08-242

In The
Supreme Court of the United States

Ross L. Bair, *et al.*

Petitioners,

vs.

United States,

Respondent.

On Petition for Writ of Certiorari from the United States Court of Appeals to the Federal Circuit

REPLY BRIEF FOR PETITIONERS

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TABLE OF CONTENTS

Page

Summary of Reply Argument 1

Reply Argument 2

Conclusion 13

TABLE OF AUTHORITIES

Cases

Alden v. Maine, 527 U.S. 706 (1999).....4
Aquilino v. United States, 363 U.S. 509 (1960).....4
Armstrong v. United States, 364 U.S. 40 (1960).....7
Bd. of Regents of State Colleges v. Roth, 408 U.S. 564 (1972).....1, 2
Drye v. United States, 528 U.S. 49 (1999).....9, 10
Gregory v. Ashcroft, 501 U.S. 452 (1991).....3, 4
Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992).....1, 2, 5, 12
Morgan v. Commissioner, 309 U.S. 78 (1940).....9
New York v. United States, 505 U.S. 144 (1992).....4
Presault v. United States, 100 F.3d 1525 (Fed. Cir. 1996).....12, 13
Printz v. United States, 521 U.S. 898 (1997).....4
Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984).....5, 6
Scranton v. Wheeler, 179 U.S. 141 (1900).....5
United States v. Bess, 357 U.S. 51 (1958).....8
United States v. Craft, 535 U.S. 274 (2002) ...7, 8, 9, 10, 11
United States v. Kimbell Foods, Incorporated, 440 U.S. 715 (1979).....7, 8
United States v. Lopez, 514 U.S. 549 (1995).....4
United States v. Morrison, 529 U.S. 598 (2000).....4
United States v. Security Industrial Bank, 459 U.S. 70 (1982).....11

Statutes

11 U.S.C. 522(f)2).....11
26 U.S.C. 6321 10
7 U.S.C. § 1421(e)(2)(A) 6
7 U.S.C. § 7284.....4

7 U.S.C. § 7301(b)(1)(J).....6

Other Authorities

The Federalist No. 45, pp. 292-293 (C. Rossiter ed. 1961) 3

Constitutional Provisions

U.S. Const. amend. X.....3

Summary of Reply Argument

In Bd. of Regents of State Colleges v. Roth, 408 U.S. 564 (1972), and Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992), this Court confirmed that property rights are derived from sources independent of the Constitution, such as state law. In Lucas, this Court also held that an individual's state-created property rights may be limited by "background principles of state law." Lucas, 505 U.S. at 1029. Numerous lower courts, including the Federal Circuit below, have impermissibly expanded these rulings, holding not only that federal legislation can act as an "independent source" giving rise to property rights, but can also serve as a "background principle" of law, thereby prospectively eliminating state-created property interests.

Through this Petition, the Court has the opportunity to clarify an important question concerning the scope of the Government's legislative authority under the Fifth and Tenth Amendments to prospectively eliminate state-created property rights. Specifically, this Court should affirm that federal statutes cannot act as "background principles" under Lucas and, therefore, cannot be used to prospectively eliminate property rights created under state law.

Reply Argument

The Government, citing Lucas and Board of Regents, acknowledges that property rights derive from sources independent of the Constitution, such as state law. The Government suggests that another "independent source" for creating property rights is federal legislation, even if such legislation redefines, and thereby eliminates, state-created property rights. It is noteworthy that the Government does not provide direct precedential support for its position, nor does it even attempt to square its expansive view of the Government's role in defining property under the Fifth Amendment with other Constitutional provisions, including the Tenth Amendment.

The origin of the "independent source" standard is found in Board of Regents, where this Court held that "[p]roperty interests, of course, are not created by the Constitution." Board of Regents, 408 at 577. The Court's use of the phrase "of course" emphasizes that the Constitution protects, but does not create, private property. Missing from the Federal Circuit and Government's analysis is any discussion as to why Congress, acting under its Constitutional authority, can do what the Constitution cannot – redefine state property rights and thereby invade an area left to the states under the Tenth Amendment. From the Growers' perspective, this explains why this Court has never expanded "independent sources" to include federal legislation, especially if such legislation invades and eliminates state-created property rights.

"The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const. amend. X. The Tenth Amendment makes it clear that the "Constitution created a Federal Government of limited powers." Gregory v. Ashcroft, 501 U.S. 452, 457 (1991). "The States thus retain substantial sovereign authority under our constitutional system." Gregory, 501 U.S. at 457. This Court has repeatedly relied on the following passage from James Madison articulating the original intended allocation of authority between federal and state governments:

> "The powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite... The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the State."

Id. at 458 (quoting The Federalist No. 45, pp. 292-293 (C. Rossiter ed. 1961)). This "constitutionally mandated balance of power between the States and the Federal Government was adopted by the Framers to ensure the protection of our fundamental liberties." Id. at 458. "Just as the separation and independence of the coordinate

branches of the Federal Government serve to prevent the accumulation of excessive power in any one branch, a healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either front." Id. at 459.

This Court has stated that States have a "legitimate and traditional interest" in "creating and defining property interests." Aquilino v. United States, 363 U.S. 509, 513-14 (1960). Further, this Court has interpreted the federalist allocation of authority highlighted in the Tenth Amendment as a limitation on federal power where there is federal interference with a matter traditionally left to the states, such as creating and defining property interests. See e.g. United States v. Morrison, 529 U.S. 598, 613 (2000); Alden v. Maine, 527 U.S. 706, 713 (1999); Printz v. United States, 521 U.S. 898, 935 (1997); United States v. Lopez, 514 U.S. 549, 552 (1995); New York v. United States, 505 U.S. 144, 149 (1992); Gregory, 501 U.S. at 460-61.

Based on the above quoted passage from James Madison and the Tenth Amendment, the Framers intended that the States retain power over property interests, which necessarily includes, at its core, the right and ability to declare what constitutes "property." Here, the federal super-priority statute, 7 U.S.C. § 7284, attempts to exercise a power traditionally reserved for the states under the Constitution by prospectively eliminating what has long been recognized under Washington law as a property right. This is precisely the type of federal overreaching that the Tenth Amendment prohibits.

The Federal Circuit below, as well as other courts holding that federal statutes can constitute "background principles" of property law under Lucas, rely exclusively on the Court's reference in Lucas to Scranton v. Wheeler, 179 U.S. 141 (1900). As discussed in the Growers' Petition, Scranton dealt with both state and federal law. Irrespective, even if Scranton is read to incorporate federal law as a "background principle," it does so only with respect to navigable servitudes, which, unlike federal legislation, are rights created under federal common law that existed at the Nation's inception. Because States possess the reserved power under the Tenth Amendment to define property interests, Lucas' citation to Scranton cannot be read as incorporating federal legislation into the "background principles" of law that redefine those rights.

Consistent with arguments it made below, the Government asserts that Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984), supports the proposition that property rights "may be defined in part by federal statutes." (Response 11). While the Growers disagree with this characterization of the Court's holding, the issue of whether a federal statute may partially redefine a state-created property interest is not before this Court. The question is whether a federal statute can redefine, and thereby ***eliminate,*** a state-created property right. This Court in Monsanto found that the federal statutory scheme at issue did not result in a Fifth Amendment taking because there was an exchange between the property owner, who possessed property rights under state law, and the

Government. No takings existed after enactment of the federal legislation, not because property rights were prospectively eliminated by an act of Congress, but because Monsanto voluntarily relinquished its state-created property rights in its trade secrets by disclosing them to the EPA in exchange for a valuable government benefit.

Monsanto is inapplicable here because the Growers never received their "valuable government benefit" in exchange for the super-priority lien priority afforded the Government. The Government points out that under the CCC loan program, the Growers were ***supposed*** to receive a valuable benefit in exchange for the CCC's super-priority lien, which is correct. This "valuable benefit," was full payment, which the Growers did not receive.[1] The Government did not live up to its end of the deal, so it cannot now claim a "valuable exchange" deprived the Growers of a compensable property interest in their state-law liens.

The Government also claims that like in Monsanto, the Growers had no "reasonable expectation" that their liens would be superior to that of the CCC. (Response 12). The reasonable expectation of the Growers is irrelevant, as this is a categorical takings case. After the Government exercised its super-priority lien, the Growers' liens

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[1] Notably, when the super-priority lien statute was first enacted by Congress, the statutory scheme contained a complementary provision guaranteeing full payment by the Government in the event application of the super-priority lien resulted in less than full payment. 7 U.S.C. § 1421(e)(2)(A). The issue before this Court arises because the full-payment provision was suspended, without any alteration to the Government's super-priority lien. 7 U.S.C. § 7301(b)(1)(J).

were rendered completely worthless, thus constituting a categorical taking. See Armstrong v. United States, 364 U.S. 40 (1960).

With virtually no analysis, the Government claims that United States v. Kimbell Foods, Incorporated, 440 U.S. 715 (1979), and United States v. Craft, 535 U.S. 274 (2002), support the Federal Circuit's holding that federal law governs lien priority when dealing with federal lending programs. The Government's passing reference to these cases overstates the significance of their holdings to this case, and fails to mention that neither case resolved a takings challenge. Even if federal law controls lien priority when dealing with a federal lending program, that priority system must still comport with the Fifth Amendment.

Ironically, in Kimbell, it was the Government that sought a "first in time," choateness federal priority rule over a more restrictive state-law based priority system. While this would not have given the Government super priority, it would have provided it with the heightened lien protection granted federal tax liens. This Court rejected the Government's request and instead looked to state law for lien priority.

The Court in Kimbell held that if Congress had wanted a priority scheme different than that afforded under state law "it would have established a priority scheme displacing state law." The Court then held that "[f]ar from doing so [displacing state law] both Congress and the agencies have expressly recognized the priority of certain private liens over the agencies' security interests, thereby indicating that the extraordinary safeguards applied in the ***tax***

lien area are unnecessary to maintain lending programs." Kimbell, 440 U.S. at 735 (emphasis added).

Thus, this Court in Kimbell held that if Congress wanted the federal loan programs to have the same heightened protection afforded federal tax liens, it would have legislatively granted them a similar "first in time," choateness federal priority rule. Critically, federal tax lien priority does not amount to a taking because prior perfected lien holders are not trumped by later-acquired federal liens. Kimbell noted that Congress could have, but did not, make such a grant of priority to the FHA and SBA. By stating that Congress could have established a federal priority scheme that displaced state law, this Court did not infer that Congress could have constitutionally granted the FHA and SBA super priority over prior perfected state-law liens, effectively granting them even more protection than that afforded to federal tax liens.

The Government cites Craft for the proposition that while state law determines what sticks are in a person's bundle of property rights, federal law determines what sticks constitute property for purposes of the federal tax lien statute. (Response at 7). To the contrary, Craft affirms the long-held view that state law determines property rights.

This Court in Craft commenced its opinion by affirming its holding in United States v. Bess, 357 U.S. 51, 55 (1958), that "the federal tax lien statute itself creates no property rights but merely attaches consequences, federally defined, ***to rights created under state law***." Craft, 535 U.S. at 278 (emphasis added). This has long been the law of the land. See

Morgan v. Commissioner, 309 U.S. 78 (1940) ("State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed."); Drye v. United States, 528 U.S. 49, 58 (1999).

In Drye, this Court held that "although the Code does not define 'property' or 'rights to property,' appellate courts read those terms to encompass '***state law*** rights or interests that have a pecuniary value and are transferable.'" Drye, 528 U.S. at 60. Construing the term "property" under the federal tax lien statute, the Court determined it applies to "state-law rights or interests" that have value and are transferable. Id.

Quoting Drye, this Court in Craft identified the relevant inquiry as follows: "we look initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer's state-delineated rights qualify as 'property' or 'rights to property' within the compass of the federal tax lien legislation." Craft, 535 U.S. at 278. That is to say, federal law is used to determine whether state-defined property interests are subject to taxation by focusing not on the label assigned by the state to those interests, but on the substance of the state-created property interests. As this Court explained:

> In looking to state law, we must be careful to consider the substance of the rights state law provides, not merely the labels the state gives these rights or the conclusion it draws from them. Such state law labels are

> irrelevant to the federal question of which bundles of rights constitute property that may be attached by a federal tax lien.

Craft, 535 U.S. at 279.

Far from using federal law to redefine property rights, this Court in Craft, like in Drye, affirmed that states define property rights and the "bundle of sticks" that make up those rights. With this in focus, the Courts in Craft and Drye looked to the substance of those state property rights in determining whether they were subject to federal taxation. Indeed, this Court in Craft spent considerable time examining the attributes of the state-created property interests in question, ultimately determining the interests were subject to federal taxation. "In determining whether respondent's husband possessed 'property' or 'rights to property' within the meaning of 26 U.S.C. 6321, ***we look to the individual rights created by these state law rules.***" Craft, 535 U.S. at 282 (emphasis added).

Craft does not stand for the proposition that a federal statute may limit state-created property rights. Craft only applied federal law as a matter of statutory construction, using it to determine what state-created property interests were subject to federal taxation. It did not apply federal law to redefine state-created property rights. Craft, 535 U.S. at 288. Nothing in the Court's opinion endorses the ability of federal legislation to eliminate state-created property rights. In actuality, the Government in Craft urged just the opposite – that

is, to *expand* the state definition of property to increase federal revenue. As such, Craft does not alter the rule of law, supported by the Tenth Amendment, that states create and define property rights. The Government's attempt to legislatively eliminate those rights is a taking.

In addressing the Growers' discussion of United States v. Security Industrial Bank, 459 U.S. 70 (1982), the Government fails to mention the most significant aspect of the case as it pertains to this matter -- the distinction between contract rights, which can be modified by bankruptcy legislation, and property rights, which can be legislatively taken only after paying just compensation under the Fifth Amendment. Even if this Court's opinion in Security Industrial Bank was meant to validate prospective application of 11 U.S.C. 522(f)2), it was only as to a creditor's contract right to repayment.

By making the distinction between contract and property rights in bankruptcy, this Court, in Security Industrial Bank, laid the foundation for the appropriate analysis of whether prospective application of Section 522 constitutes a taking. That is, while Congress' constitutional grant of authority permits it to enact bankruptcy legislation that impairs contracts, the Constitution does not authorize Congress to legislatively take state-created property rights without compensation. Because of this distinction, Security Industrial Bank does not resolve the ultimate question presented in this Petition.

Finally, the Government unsuccessfully attempts to square the opinion below with the Federal Circuit's ***en banc*** decision in Presault v.

United States, 100 F.3d 1525 (Fed. Cir. 1996). Citing Lucas, the Government in Presault argued that there was "nothing to preclude the use of federal law as well as state law in selecting the relevant 'background principles.'" Id. at 1539. The Federal Circuit's ***en banc*** opinion, however, held that "Lucas provides no such support," thereby expressly rejecting the exact ruling made by the Federal Circuit Panel in this case:

> Nothing in Lucas suggests that the background principles of a state's property law include the sweep of a century of federal regulatory legislation, and indeed much of what the Supreme Court said then, as well as in Presault II, about property rights indicates to the contrary.

Id. at 1538-39. The argument was "rejected categorically," id. at 1540, a point the Government failed to mention in its Response. Presault was correctly decided, and this Court should grant Growers' Petition to clarify this point of law for the benefit of the Federal Circuit and other lower courts.

Rather than focus on the dispositive portion of Presault, the Government instead claims that the federal laws at issue "were enacted *after* the underlying state-law interests in land were created." (Response 14) (emphasis in original). However, the plaintiffs' property rights in Presault arose with their purchase of tracts of land in 1966

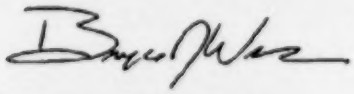
and 1980, long after the passage of federal railway law in 1920. Presault, 100 F.3d at 1537.

Conclusion

For the forgoing reasons, the Petition for Writ of Certiorari should be granted.

DATED: November 24, 2008

Respectfully submitted,



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